Due Diligence FAQs

Following are some of the questions preparers asked us about fulfilling their Due Diligence requirements and our answers:

Note: We have placed sections changed by the new due diligence requirements finalized in December 2011 in green.

Preparer Question	IRS Answer
What are the changes to the EITC due diligence requirements finalized in December 2011 and when are they effective?	Here's a summary of the changes: • All paid tax return preparers who determine the eligibility for, or the amount of, the EITC are now subject to the EITC due diligence requirements and to the penalty under section 6695(g) of the Internal Revenue Code for failure to comply. This includes preparers who sign the return, preparers who prepare the EITC portion but do not sign the return, and the employers of these preparers. • Record retention period changed to three years after the later of the date the return was due or the date it was transferred in final form by the preparer to the next person in the filing process. • Preparer must now keep copies of any documents that the client provides and the preparer used to determine eligibility for or amount of EITC. • Preparer is required to use Form 8867 and submit it with every EITC tax return or claim for refund. • The amount of the penalty increased from $100 to $500 to conform to the statutory language of section 6695(g), as amended by the United States-Korea Free Trade Agreement Implementation Act See our Preparer Due Diligence page for more information. (www.eitc.irs.gov/rptoolkit/dd/) The changes are effective for returns for tax years ending on or after 12/31/2011.

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Preparer Question	IRS Answer
I use good return preparation software. **Why can't I rely on my software** to meet my due diligence requirements?	You cannot depend on your software exclusively. Tax software is a tool to assist you and is not a substitute for your tax law knowledge and professional responsibility. You are the person who can best evaluate the information your client gives you and apply your knowledge of the law to that information. Software cannot be designed to address every possible due diligence issue you may encounter.
What are the new **record keeping requirements** that were finalized in December 2011?	You have to keep any document your client gives you that impacts or supports how you determined eligibility for or the amount of EITC. Examples include but are not limited to: • Any income documents other than W-2 forms • Income or expense documents that support Schedules C or F income including client prepared records of income and expenses • Interest income statements • Social Security cards • Guardianship records • Court placement records, etc. The new requirements **do not require you to ask for or review any more documents** than you would have under the old requirements, but now you are required to keep a **copy of any document you received from the client and relied on** to determine EITC eligibility or the amount of EITC.

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Preparer Question	IRS Answer
Is it true that if I **employ other preparers and they don't meet their due diligence requirements**, my firm can be penalized?	Yes, it's true. IRS can assess penalties against a firm that employs others to prepare tax returns if the employee does not meet EITC due diligence requirements. But, only if one of the following apply: • Management participated in or, prior to the time the return was filed, knew of the failure to comply with the due diligence requirements; or • The firm failed to establish reasonable and appropriate procedures to ensure compliance with the due diligence requirements; or • The firm establishes appropriate compliance procedures but disregards those procedures through willfulness, recklessness, or gross indifference, including ignoring facts that would lead a person of reasonable prudence and competence to investigate or figure out the employee was not complying.

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How can I as an e**mployer protect myself** from penalties caused by my employees not meeting their EITC due diligence requirements?	If you employ other preparers, here are some examples of how you can protect yourself from EITC due diligence penalties: • Review your current office procedures to make sure they address all appropriate EITC due diligence requirements • Review your procedures with your employees to make sure they clearly understand their responsibilities and your expectations of them • Conduct annual EITC due diligence training or instruct your staff to complete the online module that we offer in both English and Spanish • Test your employee's knowledge of due diligence and your procedures Perform recurring quality review checks on your employee's work including credit computations, questions they asked clients, documents they reviewed, and the records kept.
Must I use Form 8867 as part of the due diligence process?	Yes, you are required to complete, submit, and keep the Form 8867 for every EITC return or claim. You submit the form as part of an electronic return or attach it to a paper return.

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<tr><th>Preparer Question</th><th>IRS Answer</th></tr>
<tr><td>Are we required to actually go over the questions on the Form 8867 with the client and mark the forms with the answer? Or, can we later fill those forms out based on the client interview and still meet our due diligence requirement?</td><td>Paid Preparers are required to complete the Form 8867, a due diligence checklist, as part of their due diligence requirements. The intention is not to use the checklist to interview your clients. Most of your clients do not have the tax law background to answer the questions as written. IRS expects you to ask the right questions to get the information needed to complete the Form 8867. If your interview covers all aspects of your due diligence requirements, you can use the information to complete the Form 8867 as you prepare the return.</td></tr>
<tr><td>I am a paid tax preparer, do I have to submit the Form 8867 with the return or just keep with my records?</td><td>For returns or claims for refund from tax years ending on or after 12/31/2011, you are required to submit the Form 8867 either as part of the electronic file sent to the IRS or attached to a paper return. And, you must keep a copy of the completed form as part of your records for three years from the latest of the following dates that apply:
The due date of the tax return (not including extensions);
The date the return was filed (if you signed the return and filed it electronically);
The date the return was presented to the taxpayer for signature (if you signed the return and did not file it electronically); or
The date you submitted the EITC part of the return to the preparer who signed the return (if you prepared the EITC portion of the return but another preparer signed the return).
Store the checklist in either paper or electronic format but you need to produce it if audited.</td></tr>
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To **document my compliance** with EITC due diligence, is it sufficient to keep a copy of Form 8867 that is signed and dated by my client?	Keeping a signed and dated Form 8867 in your records may be sufficient to document when and from whom you got the return information, but you must also keep the computation worksheet, a record of how and when the information used to complete the computation worksheet was obtained, written documentation to support your compliance with the knowledge requirement, and any documents that you received from the client and relied on to determine eligibility for or amount of the EITC. The knowledge requirement states you must not know, or have reason to know that any information used in determining your client's eligibility for, or the amount of, EITC is incorrect. ***You*** must ask additional questions if the information your client gives you seems incorrect, incomplete or inconsistent. ***You*** are required to document the questions asked and the answers given at the time of the interview. For example, a client says he is self-employed and has income of $15,000 but has no records showing income or expenses. A reasonable tax return preparer would ask further questions to determine how the client computed the income and expenses without any records. You are required to document the questions asked and the answers given at the time of the interview, and to keep this documentation either electronically or on paper.

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When questioning a client who reports i**ncome** that seems **inadequate to support a family**, is it sufficient to accept an answer that the client receives government benefits? Do we need to specify the type and amount?	Questioning the source and amount of income used to support a household for EITC due diligence has two purposes. One is to ensure your client is reporting all income that contributes to their total earned income and AGI. There is no support test for EITC. And, the other purpose is to ensure no other person is eligible to claim EITC or any other child-related benefits Your due diligence requirement is to make additional inquiries if the information you receive from your client appears to be incorrect, incomplete or inconsistent. You **do need** to know the source of income and amount to determine filing status and dependency exemption. Documenting all sources of support is sufficient.
It is my understanding that you have to report all income but what about deductions or expenses. Does my client **have to claim all business expenses**	A self-employed individual is required to report all business income and deduct all allowable business expenses. They do not have the option of reporting what is most beneficial. Revenue Ruling 56-407, 1956-2 C.B. 564, addresses whether taxpayers may disregard allowable deductions in computing net earnings from self-employment for self-employment tax purposes. Rev. Rul. 56-407 held that under §1402(a), every taxpayer (with the exception of certain farm operators) must claim all allowable deductions in computing net earnings from self-employment for self-employment tax purposes. Because earned income for purposes of the EITC includes net earnings from self-employment determined under section 1402(a), this revenue ruling applies to determine the correct amount of earned income under section 32(c) (2) (A)(ii).

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What should a preparer do if he or she feels the **taxpayer is not providing all expenses** to inflate EITC?	As a preparer, you need to be alert to this type of situation. Part of the knowledge requirement is that you know or have reason to know, so you can't ignore your suspicion. Here is when you need to ask additional questions, document the answers and make a judgment as to whether the answers make sense. If they don't, you have a responsibility to ask additional questions and possibly ask for documentation until you are confident the return you are preparing is accurate. You must also use professional judgment regarding the credibility of your client and the answers you receive. If you are not comfortable with the answers or credibility of the client, then due diligence dictates you do not prepare the return. You may also want to present your client with the new Publication 4717, Help Your Tax Preparer get You the EITC You Deserve. This publication explains preparers' due diligence requirements and the consequences of not filing an accurate return.
Must I review the birth certificate to verify the age of a qualifying child?	No, it's not required. However, if you have reason to question a child's age, you may want to request the birth certificate. If the client provides a birth certificate and you use it to determine eligibility for or amount of EITC, you need to keep a copy.

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How do you handle the situation when you **decline to do the EITC** claim? What if the client then refuses to leave his or her information with you?	Any client has the option of deciding not to complete a return with a preparer. If that is the case, the client would have no reason to leave information with that preparer. If you want to report a person who you think will erroneously claim EITC with another preparer, use the process described in the Fraud section of the Frequently Asked Questions.
What due diligence is expected of the preparer in this situation: The household is made up of an unmarried couple, their natural child and the grandmother of the child. The child is the qualifying child of all three for EITC. The grandmother is our client and neither one of the parents is our client. The grandmother says they all agreed she should take the credit and she has the highest income. **What responsibility do we have to verify this information**?	To meet your due diligence requirements, you must ask the appropriate questions and document the questions you asked and your client's answers. You do not have the responsibility to verify the AGI of the parents. As a service to your customer, you may want to explain what happens when more than one person uses the same qualifying child--the return may reject or IRS could reverse the claim after an audit. You may also want to present your client with the new Publication 4717, Help Your Tax Preparer get You the EITC You Deserve. This publication explains preparers' due diligence requirements and the consequences of not filing an accurate return.

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We have a checklist to make sure our clients are eligible for EITC. We determined they were not and did not claim EITC on the return. But, the **IRS sent a letter saying they might qualify**. Why?	If your client appears to qualify for EITC but does not, you should put a "no" on the EITC line. IRS does check for the "no" on the EITC line before sending out a notice. Some preparers have indicated that sometimes they put "no" on the EITC line, but IRS sends the letter anyway. The information in IRS reports does not indicate the source of the error (whether IRS error, software error or preparer error). Therefore, if you have a case and have the records to show that the taxpayer did not qualify for the EITC, and that "no" was on the EITC line, please contact us at eitc.program@irs.gov. Don't send specifics. We will get back to you if we need details.
Do due diligence requirements, including the three-year retention, **apply to VITA prepared returns**?	No. The due diligence requirements apply only to paid return preparers.
Must I review Social Security cards or keep a copy?	No. There is no requirement to review Social Security cards, but it is a best practice to review them. You are more likely to get the child's name and number correct if copied directly from the card. Also, having copies of cards is helpful in resolving e-file rejects. If the client provides a Social Security card and you use it to determine eligibility for or amount of EITC, you need to keep a copy.
How is a **preparer selected for an EITC Due Diligence audit**?	IRS selects preparers for due diligence visits based on the high likelihood that the returns they prepare are in error. We base the likelihood on a set of standard criteria applied to all EITC returns. See What to Expect during a Due Diligence Audit for additional information.